

Finance and Resources Committee Meeting – 6<sup>th</sup> February 2008

## VAT DE-REGISTRATION PAPER

### Executive summary and recommendations

#### **Introduction**

#### **Decision**

The Committee is requested to note the document. No decision is required.

#### **Background information**

Following discussion with HMRC on HPC's behalf, Baker Tilly advised on 19<sup>th</sup> December 2007 that the option to tax (VAT registration) will be disappled once the Stannary St property is first used after refurbishment and once the 'election to waive exemption' documentation is received, including original VAT documentation. The Executive is in the process of requesting the original VAT documentation from BDO Stoy Hayward, as by arrangement, this was not captured by BDB, the solicitors handling the sale and purchase transaction.

Baker Tilly advised on 24<sup>th</sup> January 2008 that VAT needs to be paid on the building work up to the point of project completion, on the grounds that HMRC will argue that such VAT did not relate to the intention to make taxable supplies. That is HPC were aware that the option to tax would be disappled once the refurbished property is first used. This is an update on Baker Tilly's February 2006 advice – see Appendix One.

The amount of VAT liability at 31 December 2007 including input tax and less any output tax (on the supply of space to HPC by 22/26 Stannary St Ltd) is £92k. By the end of the building project, the VAT amount repayable is estimated at £204k, relating to both Opex and Capex items purchased.

Note that the VAT amount repayable has no impact on the year end surplus position, other than tax advisor charges. To elaborate, the 22/26 Stannary St capex budget was budgeted for gross of VAT and the any notional supply of space (output tax) and input tax relating to the building work shown in the balance sheet, not the income statement.

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2008-01-28	a	F&R	PPR	VAT Deregistration paper	Draft	Public
					DD: None	RD: None

A financial provision has been made for the full amount of VAT reclaimed to date and will be updated at 31<sup>st</sup> March 2008. Baker Tilly auditors were notified of the need for the provision on 24<sup>th</sup> January 2008 on the grounds that 'it is probable that a transfer of economic benefits will be required to settle the obligation' and Baker Tilly Tax Dept advised that 100% probability of the obligation will become payable to HMRC.

**Financial implications**

Nil impact on the Income Statement, other than tax advice received on the de-registration.

**Appendices**

Appendix One – Baker Tilly VAT De-registration advice dated 27<sup>th</sup> February 2006

**Date of paper**

25<sup>th</sup> January 2008

**27<sup>th</sup> February 2006**

**Health Professions Council  
22 – 26 Stannary Street Ltd  
Value Added Tax (from Michael Ussher, Senior Tax Manager, Baker Tilly)**

**Background**

The Health Professions Council (HPC) is a corporate body created by Statutory Instrument. Its income is received solely from health professional's registration fees.

The HPC is not registered for VAT and all of its income is treated as being outside the scope of VAT being a statutory fee.

In 2005, the HPC acquired the share capital in a company now called 22 – 26 Stannary Street Ltd (Stannary Co). Stannary Co owns a commercial property at 22 – 26 Stannary Street.

Stannary Co had previously taken the decision to charge VAT on this property and consequently the property is an elected property for VAT purposes. Any supply of the property by Stannary Co (either by rental, lease or freehold sale) will be taxable for VAT purposes. It is not at present known when this election was made or notified to Customs.

It is intended that the property will be substantially renovated at an estimated cost of £750k and occupied by the HPC. There is at present no intention to rent the property to any third party.

**VAT Position**

For VAT purposes, HPC and Stannary Co are "connected persons".

Where a taxable supply is made between connected parties and the recipient of the supply is not entitled to recover input VAT, the supply must be valued at the open market value.

Consequently, if HPC occupies the property, the value of the notional rent will be the open market value and Stannary Co will need to account for VAT on this amount to Customs.

As long as the value of the notional amount received exceeds the VAT Registration threshold (currently £60k), Stannary Co will be required to remain registered for VAT.

Additionally, if Stannary Co transferred ownership to HPC, a deemed supply of the property would take place on which Stannary Co would be required to account for VAT at the open market value.

Consequently, in normal circumstances as this is an elected property, a VAT cost would accrue to HPC.

## **Options available**

### **1. VAT Grouping**

One measure which could resolve the VAT issue and reduce the VAT cost would be to set up a VAT Group. A VAT group is treated as a single VAT entity and any transactions between Group members is disregarded.

Whilst this would mean that the HPC would have to register for VAT it would also mean that the VAT charge on the notional rent would no longer apply.

A complication with this solution however is that the VAT Group would not be making any supplies outside the VAT Group (HPC's income being wholly outside the scope of VAT) and it may not be straightforward to obtain Customs agreement to accept the setting up of a VAT Group.

### **2. Anti Avoidance measures**

A number of complicated VAT anti avoidance measures have been introduced in recent years in the property sector. These measures are generally aimed at certain business sectors but they do have a general application.

One of the anti avoidance measures results in the election to charge VAT being disapplied in the following circumstances:

- The property is a capital item for VAT (ie. the property was bought at a cost of more than £250k or works of refurbishment, enlargement or alteration have been carried out in excess of that amount)
- The occupant is connected to the landlord and directly or indirectly funded the cost of the purchase or works
- The occupant cannot recover VAT

Clearly, the occupant HPC is funding the renovation works and it cannot recover its VAT and it would therefore seem that if the planned renovation work were contracted directly between the contractor and Stannary Co, the property would become a capital item and the disapplication rules would apply (Alternatively, HPC could retain the contracts with the contractor but HPC would then need to make an onward supply of construction services to Stannary which would require HPC to register for VAT).

No VAT would be recoverable on the construction costs by Stannary Co but no VAT would be chargeable on the notional supply of the property to HPC.

#### **Cancellation of Stannary Co VAT Registration**

If the above disapplication rules applied and Stannary Co was only making supplies of the property to HPC, Stannary Co would be able to cancel its VAT Registration.

**However, if HPC were to vacate the property and an unconnected third party were to occupy the property, Stannary Co would be required to register for VAT again if its election has not been revoked within the new revocation provisions (ie 20 years had passed since the date of the original election to charge VAT).**

### **Conclusions**

Whilst the VAT Grouping option is available, it is likely that any application to set up a VAT Group would be at the least questioned by Customs.

In addition, if the application were successful, HPC would then be registered for VAT, both parties would have joint and several liability for any VAT debts and VAT Returns would need to be completed and submitted on a regular basis to Customs (even if these were effectively nil returns).

By using the disapplication rules and making sure that the contracts for the construction work were between the contractor and Stannary, an application to cancel the VAT Registration could be made. This would also provide an opportunity to advise Customs of the circumstances surrounding the transaction to effectively obtain clearance on the arrangements.